

WATER DISTRICT UPDATE

ISSUE No. 2 ♦ MAY 1997

Directors' Fees—Treatment by IRS.....

According to sources with the Internal Revenue Service (IRS), some confusion may exist about the proper treatment of fees paid to water district directors. Section 1402 of the Internal Revenue Code states that the performance of the functions of public office for compensation based solely on a fee basis is self-employment (SE) income. Therefore, the fees paid to the water district directors are SE income to them. The water district must use Form 1099-MISC to report the fees to its directors and to the IRS. The directors must report their fees as SE income on Form 1040 Schedule C.

The following paragraphs are a summary of our response, after consulting with staff of the Internal Revenue Service, to frequently asked questions about directors' fees. None of these

responses should be substituted for direct communication with the Internal Revenue Service or individual legal counsel.

FICA Tax

Are the fees paid to water district directors subject to Federal Insurance Compensation Act (FICA) tax? No. Under Section 3121 of the Internal Revenue Code, fees for services performed in the employ of any political subdivision of a state are exempt from the "employment" definition for FICA tax. Therefore, the water district will not withhold the FICA tax from the directors' fees or pay it to the IRS.

Unemployment Tax

Are the fees subject to Federal Unemployment Tax Act (FUTA) tax? No. Under Section 3306(c)(7) of the Internal Revenue Code, payments to water district directors are exempt.

Self-Employment Tax

Are fees paid to water district directors subject to self-employment tax? Yes. The directors must report the fees they receive from the water district as self-employment (SE) income on Form 1040 Schedule C. To the directors, this income is no different from any other SE income and is subject to the SE tax.

Some Terms Used in this Publication

We use the phrase **water districts** to establish a common term among the various types of general law and special law districts; this publication provides general information and updates of interest to such districts. The pronoun **we** means staff of the Water Utilities Division of the Texas Natural Resource Conservation Commission (**TNRCC**); we use "**commission**" as a synonym for TNRCC. The phrase **TNRCC rules** means the regulations found in Title 30 of the Texas Administrative Code (TAC).

SE Income versus Employee Income

Is all remuneration from a district considered self employment income? Not necessarily. Services performed as an employee of the district are employee services subject to withholding and reportable on Form W-2. If a worker or a director performs services other than administrative, such as repair or maintenance of equipment or maintenance of grounds, the reimbursement for those services is subject to the employment rules of the IRS. If you have any questions, please contact Jack R. Gray, Employment Tax Group Manager, Internal Revenue Service at (281) 721-7931. ■

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Frequently Asked Questions

Here are our responses to questions that the Water Utilities Division often receives.

Fund Transfer

Can a municipal utility district transfer interest and penalty funds from the debt service account to the general fund while it has bonds outstanding? No. As a controlling principal, districts are authorized to exercise only those powers expressly delegated by the Legislature. *Tri-City Fresh Water Supply v. Mann*, 142 S.W. 2d 945 (Tex. 1940). Also see *Attorney General Opinion JM-142 (1984)*.

Write-Offs

Can a district write off 10 years of bond taxes receivables when all outstanding bond issues have been fully retired? No. Texas Property Tax Code §33.05 states that personal property cannot be seized and a suit may not be filed to collect a tax on real property that has been delinquent for more than 20 years. The collector for a taxing unit will cancel and remove from the delinquent tax roll a tax on real property that has been delinquent for more than 20 years if there is no pending litigation concerning the delinquent taxes at the time of cancellation and removal.

Also, this Section prohibits a taxing unit from filing suit to recover taxes more than 4 years delinquent. *Flowers v. Lavaca County*, 766 S.W. 2d 825 (Tex. App. Corpus Christi 1989, writ denied). Therefore, according to the Property Tax Code, if the taxes have been delinquent more than 20 years, the collector of the taxing unit must cancel and remove the delinquent tax liability. The TNRCC is not authorized to grant water districts permission to write off delinquent bond tax receivables.

SDWA Reporting Requirements

What will be the commission's reporting requirements under the Safe Drinking Water Act? The Safe Drinking Water Act (SDWA) Amendments of 1996 established a new charter for the nation's public water systems, states, and the Environmental Protection Agency (EPA) in protecting the safety of drinking water. These amendments include, among other things, new prevention approaches, improved consumer information, changes to improve the regulatory program, and funding for states and local water systems. Copies are available from the Government Printing Office at (202) 512-1808. The EPA has summarized the changes on a Web page, <http://www.epa.gov/OGWDW>.

The TNRCC has the responsibility to implement the SDWA in Texas. Any changes in the reporting requirements for water districts as a result of the SDWA will be made by commission rule, issuance of a regulatory guidance document, or changes to the Annual Audit Report Requirements (AARR) for Texas Water Districts and Authorities (TNRCC publication RG-81). Before making any changes to the reporting requirements on this issue, the TNRCC is waiting for the EPA to implement federal guidance.

Using Surplus Funds and TNRCC Approval

Does the TNRCC have to approve the use of surplus funds derived from cost underruns or interest earnings on construction funds when such funds are used to finance cost overruns? A district can use the contingency funds included in the bond issue cost summary to fund cost overruns on any projects included in

the bond issue without further TNRCC approval. However, if the contingency funds have been consumed and the district wants to use available surplus funds, TNRCC approval must be obtained as required in the Rules before the expenditure of those funds (Rule 30 TAC 293.82, change in project scope; and Rule 30 TAC 293.83, use of surplus funds). Approval also must be sought for using such funds to finance cost overruns of approved projects.

Interest on Deposits

Do districts have to pay interest on customer deposits? No. According to Water Code §49.212 (b) "a district may require a deposit for any services or facilities furnished and the district may or may not provide that the deposit will bear interest." As a good business practice, a district should adopt and make available in writing to its customers a policy governing its deposits, which addresses, at a minimum:

- ♦ whether the board has authorized the deposits to bear interest and, if so, at what rate; and
- ♦ when a deposit is eligible for refunding.

Typically, a board will consider the stability of an account and its history of prompt payments. For example, a district might release the deposit of a homeowner who has had no delinquent bills in the past 12 months. Most districts however retain the entire deposit amount until after the account has been closed.

Interest Earnings and Escrow

Is it necessary to require that interest earnings on escrow funds remain in escrow? Escrow requirements do not apply to interest earnings, unless specifically included in the Order directing

that the funds be escrowed. Interest earnings are considered by rule to be surplus funds, which are subject to the TNRCC rules.

Delinquent Accounts and Permissible Fees

Can a district charge a new customer a “reserve service” fee or a “reservice” tap fee to cover the delinquent account of the previous customer? As a condition of providing service, can a general or special law district require a service applicant to pay the delinquent bill of a former customer at the same location?

Recovering Delinquencies

(Please notice that our response gives the general rule in the first paragraph that follows and the exception in the third paragraph.)

General Rule. A district can only do what it is expressly authorized to do. There are **no** provisions in Chapters 49 or 65 of the Texas Water Code that would allow the district to:

- ♦ hold a customer responsible for the prior customer’s outstanding account balance,
- ♦ charge more than once for a tap fee, or
- ♦ charge for services that a resident does not receive.

The prior customer’s deposit must be used to recover any outstanding amounts owed. If the deposit amount does not cover the outstanding balance in full, the district cannot hold another customer responsible for the payment of the account. The district’s only recourse to collect the outstanding balance is to pursue the nonpaying customer.

Delinquency Recoveries—Exception.

A district may not condition service to a new customer on payment of outstanding charges incurred by a prior customer, *unless* a legal relationship between the

“Circuit Rider” Program Helps Small Districts

To help small water and wastewater utilities, including water districts, serve their customers better, TNRCC’s Water Utilities Division can arrange on-site technical and management assistance through the Circuit Rider Program. (The program’s name comes from the fact that the contracted consultants “ride” around the state to consult on-site with utilities and districts.) Assistance is available with:

- ♦ utility operations and management, including the development of customer service policies and procedures, technical operations, water conservation, leak detection, compliance with the Safe Drinking Water Act, and other operating and management issues;

- ♦ financial management, including bookkeeping, accounting, cash and inventory control, business planning, and budgeting; and
- ♦ education and training, in the form of publications and seminars.

These services are provided through the regulatory assessment fees paid by utilities. The TNRCC must coordinate all referrals to utilities needing assistance. For assistance please contact:

Utility Assistance &
Certification Team
Water Utilities Division
(512) 239-6960

two customers causes the new customer to be liable for the debts of the other, or unless the new customer had agreed in writing to be responsible for the charges incurred by the previous customer.

Types of Permissible Fees

Capacity Maintenance. A district can and should recognize the cost associated with maintaining service capacity year-round. A rate structure may be designed to consider seasonal use of a district’s service. For example:

- ♦ A seasonal rate structure may be adopted that considers periods of reduced service revenue income.
- ♦ A seasonal reconnect fee may be adopted, under which the district may charge up to six times the minimum monthly fee at the time that a resident returns to use the district’s services, provided that the resident returns within a 12-month period.

Tap Fee. A tap fee is a one-time charge assessed to cover the actual costs of physically tapping the main and installing the meters, meter boxes, fittings, and other materials; setting up the new customer’s account; and allowances for equipment and tools used. Once the tap is in place, no further costs are incurred by the district for this purpose. Since the tap fee has already been paid by the prior customer, no additional tap fee should be assessed. TNRCC legal staff has determined that, without specific authorization to the contrary, general law districts cannot remove a water tap, which is considered a permanent improvement to the property and a district asset.

Impact Fee. An assessment for the initiation of district services three times above the actual cost of providing the tap may fall within the definition of an

(continued on next page)

Frequently Asked Questions *(continued from page 3)*

impact fee (V.T.C.A., Local Government Code, Chapter 395). The assessment of impact fees requires TNRCC approval or compliance with the procedures set forth in Chapter 395 of the Local Government Code.

Inactive versus Terminated Connection

Utility law has long held that a resident maintains the liberty to refuse the use of a utility service. However, a distinction should be made between an inactive connection and a terminated connection.

- ♦ If the service is *inactive* at the option of the customer, but has not been disconnected by the district, a minimum service charge may be assessed.
- ♦ If the service is *terminated* by action of the district or at the request of the customer, a minimum service charge should **not** be assessed.

The request for termination must be honored, but the district may charge for the cost of the disconnection and reconnection. It is the customer's responsibility to weigh the cost involved and decide whether to request a termination and pay the associated fees or to continue as an inactive account and pay a minimum charge.

Unpaid Taxes and "Global Disconnects"

Can a district discontinue utility service to a taxpayer's residence and/or commercial business for not only the unpaid taxes that may be due on the taxpayer's residence and/or commercial business, but also for delinquent taxes on any undeveloped properties that the taxpayer also owns within the district? Probably not. Section 49.212(c) of the Texas Water Code authorizes districts to

discontinue utility service for nonpayment of charges, fees, and taxes. The Water Code is unclear on whether this provision authorizes "global disconnects."

The Texas Supreme Court, in a case involving an electric utility, held that "global disconnects" are oppressive and are violative of the public duty. Historically, Texas courts have considered similar action by public utilities to be coercive, oppressive, and a breach of the public duty, unless specifically authorized in a utility service contract.

Security Fee and Service Termination

Can a district terminate its services if a resident does not pay a monthly charge for security patrols? Water Code §49.216 provides districts the ability to contract for security services, and §49.212 provides districts the ability to discontinue a service to enforce payment of an unpaid charge. Terminating paid up utility services for nonpayment of a security patrol fee would be inappropriate. When deciding whether to terminate a current account for nonpayment of the security patrol fee, a district should carefully consider existing case law, potential adverse effects to the public health, and the district's ability to seek a remedy in the appropriate legal forum for the unpaid fee.

Land Purchases

Does the board of a general law Water Control and Improvement District have the legal authority to purchase land as an investment? No, a district is not authorized to purchase land only as an investment. However, a district can purchase land if it is necessary for accomplishing any of the district's primary purposes—for example, as a site for a water treatment plant.

Confirmation Election

Are Levee Improvement Districts created before September 1, 1995,

pursuant to Chapter 57 of the Water Code, required to hold a confirmation election before issuing bonds or other obligations? No. Water Code §49.102 (confirmation and director election) only applies to proposed districts.

Election Exemptions

Are there any districts that are exempt from the recent election law change requiring districts to convert to elections in even-numbered years in January or May? Yes. The following districts are not subject to the election provisions of Chapter 49:

- ♦ districts operating under the provisions of Chapter 36 as groundwater conservation districts;
- ♦ districts operating under the provisions of Chapter 60 through 63 as navigation districts or port authorities; or
- ♦ any conservation and reclamation district created pursuant to Chapter 62, Acts of the 52nd Legislature, 1951 (Article 8280-141, Vernon's Texas Civil Statutes), as defined by Section 49.001(a)(1).

Clarifying "Per Annum" Reporting of Fees

What is the commission's reporting requirements on the "\$6,000 per annum" reimbursement authorized under Water Code §49.060, Fees of Office? We require that "per annum" reimbursement be reported in the district's annual audit report using Supplemental Schedule N for Board Members, Key Personnel, and Consultants. There are two columns to show how much each person or company was paid during a district's 12-month accounting period (its fiscal year). The first column should show the monies paid for fees of office. The second column should detail the actual expense reimbursements. ■

Standby Fees

The Creation and Bond Review Team has issued its Standby Fee Application Report Format (SFARF), which helps districts complete the standby fee application. To get a copy, call TNRCC's Publication Unit at (512) 239-0028 and ask for TNRCC publication RG-260.

More Districts Can Apply for the Fee

Most types of water districts now have authority to levy standby fees after obtaining TNRCC approval (Texas Water Code §49.231, effective September 1, 1995). Previously, only water control and improvement districts or municipal utility districts could apply for commission approval to levy a standby fee under Water Code §50.056, which was repealed by the 74th Legislature on September 1, 1995.

According to Water Code §49.231(b), a district "that proposes to provide or actually provides retail potable water or sewer utility services, or drainage services as the principal function of the district, may, with the approval of the Commission, adopt and impose on the owners of undeveloped property in the district a standby fee in addition to taxes levied by the district. . . . The district may impose standby fees in different amounts to fairly reflect the level and type of services and facilities available to serve different property. The intent of the standby fee is to distribute a fair portion of the cost burden for operating and maintaining the facilities and for financing capital costs of the facilities to owners of property who have not constructed improvements but have potable water, sewer, or drainage capacity available."

Standby fees may be used to pay operation and maintenance costs associ-

ated with maintaining the district's facilities, and/or to pay debt service payments on bonds outstanding for water, sewer or drainage facilities.

Standby fees imposed according to Water Code §49.231 are a personal obligation of the person owning the undeveloped property on January 1 for the year the standby fee is assessed.

TNRCC Approval: Major Conditions and Limits

According to Water Code §49.231 (f), the commission will approve a district's standby fee application "only if the commission finds that the fee is necessary to maintain the financial integrity and

stability of the district and fairly allocates the costs of district facilities and services among property owners of the district."

The TNRCC can approve a standby fee levy for a maximum of three years. A district must submit another application to renew its authority to levy standby fees.

SFARF Accessible via Internet. The SFARF can be downloaded from the Internet at <http://www.tnrcc.state.tx.us/water/wu/district/distpubs.html>. To read this file format you need Adobe Acrobat Reader, which can be downloaded from <http://www.adobe.com>. The SFARF also can be accessed from TNRCC's Web site by, for instance, clicking on [Water Utilities](#) or [Water District Information](#), then on [District Administration](#) and [Forms](#). ■

Registration Form Revision.....

Whenever water districts undergo a change in board members, consultants, and other personnel specified on TNRCC's registration form (TNRCC-0179), the changes must be reported within 30 days. When submitting an updated form, **fill out only items that have changed since your last submission.** For example, if only one director's address and phone number changed, then just list that person's new information in Section A of the form. Your prompt notification of TNRCC about these changes helps ensure that the agency's mailing list remains accurate and that your district's key personnel receive time-sensitive information they need to know.

A late-1996 revision added two items to the form: (1) disclosure of each district's meeting place and (2) the location of the official records. You can download TNRCC-0179 from the Internet at

<http://www.tnrcc.state.tx.us/water/wu/district/distpubs.html>

To view this file format you need Adobe Acrobat Reader, which you can download from <http://www.adobe.com>. The registration form also can be accessed from TNRCC's Web site by, for instance, clicking on [Water Utilities](#) or [Water District Information](#), then on [District Administration](#) and [Forms](#).

Summary of Changes in the AARR.....

Each district should have received a copy of the Water District Accounting Manual (WDAM) and the Annual Audit Report Requirements (AARR) for Texas Water Districts and Authorities, revised and issued in December 1995. The AARR is effective for all audit reports with Fiscal Year Ends after March 31, 1996. Please contact the Publications Unit at (512) 239-0028 to receive additional copies of the WDAM (TNRCC publication RG-80) and the AARR (TNRCC publication RG-81).

Revisions were required due to changes in the statutes, new accounting and auditing requirements and the reorganization of the TNRCC and the Texas Administrative Code. The purpose of the manuals is to provide accurate and current information on financial recording and reporting requirements for water districts.

If your district has already completed its annual audit report according to the December 1995 version, please ensure that the district considers the revised page IV-1 when preparing the next fiscal year's audit report.

The TNRCC is **not** requiring a resubmission of the audit report. We apologize for any confusion caused by making the supplemental reporting requirements follow the language in 30 Texas Administrative Code 293.92 "Additional Reports and Information Required of Certain Districts."

We have revised the Water Code cites in the manuals to reflect the changes caused by the passage of Senate Bill 626,

the "recodification bill." This bill took most of the administrative provisions of the Water Code relating to water districts in Chapters 50 through 66 and combined them into a new chapter, Chapter 49. Most changes were effective on September 1, 1995.

Filing Affidavit. The Annual Filing Affidavit, included in the AARR, was also revised in August 1995. Districts are no longer required to file a copy of the audit report with the city or county clerk's office. The affidavit was previously revised

to include the language from the former board certificate stating that the district has reviewed and approved its annual audit report. The new format includes a line for listing the location of the district's office and its records. Also, any duly authorized district representative can now sign the affidavit.

Notes to the Financial Statements. The debt service compliance note should specifically disclose the escrowed and reserved amounts, the use of surplus or escrowed funds, and whether TNRCC approval is required.

The Supplemental Schedules. Based on comments received, we have attempted to simplify reporting requirements for the supplemental schedules. The requirement for preparing the schedules and the Management Letter has changed. Each water district that is proposing to provide or is actually providing as its principal function **water, sewer, drainage, or flood control/protection facilities or services** must additionally prepare and present Supplemental Schedules C–N behind the notes to the financial statements. This provision does **not** apply to:

- ♦ districts whose **only** purpose is to provide irrigation, navigation, or groundwater control;
- ♦ municipal management districts;
- ♦ river authorities or special law districts listed in 30 Texas Administrative Code 292.1.

Schedule E—Services and Rates. We have switched the order of Items 3 and 5. Item 3 is now the service providers connection summary. This item has an additional column for the active equivalent single family connections (ESFC). We have received several requests to clarify our instructions for reporting the ESFC. This can be an estimated number. It should be available from the district's engineer or operator. As defined in the Developer's Bond Application Report Format (TNRCC publication RG-178) in Section 6 on pages 14 and 15, "unless otherwise justified by usage data or required by applicable rule, law or regulatory requirement, an ESFC is equivalent to a single-family home with 3.0 persons (300 gallons per day of return wastewater flows or approximately 360 gallons per day of water supply)." The active connections are those that the district is billing for service.

Item 5 is now the standby fees section. We have altered the required information on standby fees. We require that the total levy amount, the total amount collected, and the total percentage collected be listed for each fund. In addition, Item 5 calls for information about whether the standby fees have received TNRCC approval and carry a lien status. Item 7 is the new portion of the schedule regarding the district's location.

Schedule G—Temporary Investments. The TNRCC requires that **all** districts prepare this schedule and include it as a supplemental statement to

New Page to Insert in Your 1995 AARR

On page 11 of this newsletter you will find a new version of page IV-1 of the AARR (TNRCC publication RG-81). Copy this page and substitute it for page IV-1 in your December 1995 edition of the AARR. We will not re-issue the entire AARR for this one change.

the general purpose financial statements, even if the district is not required to file Supplemental Schedules C–N.

Schedule H—Analysis of Taxes Levied and Receivable. We have added a line item to allow for reporting other district tax levies, such as a contract tax. Also, the percentage of taxes collected to taxes levied has been altered in calculation and presentation. We now require the collection percentage number for the current tax year and the previous three tax year levies.

We have also received requests to clarify our instructions for reporting overlapping tax rates. List the names of all taxing entities—including the county, city, and school district—that tax property within the district. If the district is in Harris County, the county tax rate should include all the taxes collected by the County Tax Collector’s Office for Harris County. These taxes include, for example, Port of Houston, Harris County Junior College District, Harris County Hospital District, and Harris County Flood Control District. Other counties should include only the county taxes in the county rate. Any other county-wide districts not included in the county rate should be listed under Special Districts. List any special districts that are not included in the previous sentences. These may include hospital districts, junior college districts, navigation districts, master districts, drainage districts, or levee improvement districts. The total overlapping tax rate is the sum of those rates listed.

If more than one taxing jurisdiction **of the same type** overlaps in the district, see the example in the accompanying table. In this example, only the school district with the greatest percentage of overlap is included in the total. If both school districts were to have the same percentage of overlap, the school district with the higher tax rate should be used.

Schedule K—Analysis of Changes in General Long-Term Debt. We revised this schedule to include an item that previously was on Schedule J—“Debt Service Fund Cash and Temporary Investments Balances as of Fiscal Year Ending.” We have also added the item “Average Annual Debt Service Payment (Principal & Interest) for Remaining Term of All Debt.”

Schedule L—Comparative Schedule of Revenues and Expenditures, General Fund and Debt Service Fund, Five Years. We reformatted this schedule to add the total number of active retail equivalent single-family units of water and/or wastewater connections as a line item throughout the past five years. We are trying to determine the build-out ratio of the district and see whether the customer base is stable, increasing, or decreasing. There is a typographical error in this schedule: on the table’s last row, “total active retail water and/or wastewater connections,” there should not be anything presented in the five columns with the overall heading “percent of fund total revenues.”

Schedule N—Board Members, Key Personnel, and Consultants. This schedule now includes a listing for the district’s investment officer. The invest-

ment officer can be either a district director or a district employee.

Appendix A—Applicable Law. This appendix contains sections from Chapter 49 of the Texas Water Code. Qualified districts may elect to file an annual financial report if they do not collect any taxes. The exemption levels for filing an annual financial report have been increased to \$100,000.

Appendix E—Developer Reimbursement Audits. We revised this appendix to include maintenance tax revenues as a reason for preparing the developer reimbursement audit. The Auditor’s Report must now include the date, the district’s complete mailing address, and the signature of the auditor or audit firm. We have combined the previous Schedules A and A-1 into a new Schedule A for calculating the amount to be paid to the developer. This schedule bases the interest on a disclosed expected reimbursement date. Schedule B contains a new column to disclose the percentage variance over or under.

Appendix F—Notes to the Financial Statements. Updates references to the Codification of Governmental Accounting and Financial Reporting Standards. ■

| When Tax Jurisdictions of the <i>Same Type</i> Overlap: How to report total overlapping rate in Schedule H | | |
|---|---------------|----------|
| Overlapping Jurisdiction | % of District | Tax Rate |
| County | 100% | \$0.50 |
| City | 0% | \$0.00 |
| School Districts: | | |
| Hill Top Ind. Sch. Dst | 75% | \$1.25 |
| Pine Valley Ind. Sch. Dst. | 25% | \$1.50 |
| Other Special District | 0% | \$0.00 |
| Water District | | \$0.80 |
| TOTAL Overlapping Tax Rate | | \$2.55 |

Finding a Qualified Auditor And Ensuring a Quality Audit

How can your district engage a qualified auditor and ensure that he or she performs a good-quality audit? We briefly review some essential principles and procedures, and give you a checklist of points to include in a Request for Proposals and when reviewing the auditor's Engagement Letter.

Board Members' Responsibility

The board members are ultimately responsible for the district's financial disclosures, not the independent auditor, the consultants, or the staff. A board member can be held personally liable for the representations made in the district's financial reports and for the management of funds and accounts.

The Independent Auditor's Role

The audit process is an important aid to the board in fulfilling its responsibilities. The auditor represents in the "Independent Auditor's Report" that the audit was conducted in accordance with generally accepted auditing standards and that the financial statements are free of *material* misstatement.

In performing the audit, the auditor should disclose to the board poor internal control practices or noncompliance with laws or regulations that come to his attention. Such disclosure, properly acted upon, can lessen the overall financial loss to a district and can reduce the board members' exposure to liability for allowing the existence of poor management practices or illegal transactions.

How to Ensure a Quality Audit

Qualify the Auditor! The proper way to qualify auditors is to use the Request for Proposals (RFP). The RFP is a formal communication to potential auditors in which the nature, terms, and other requirements of the audit are described. In the RFP, ask for the auditor's credentials. A qualified auditor should have current continuing education in governmental accounting and auditing and be experienced in performing governmental audits.

Evaluation of Proposals

Do not take bids! The Professional Services Procurement Act (see TNRCC publication RG-279) states that political subdivisions of the state **must not** engage the services of a CPA selected on the basis of competitive bids; instead they must select, award, and engage such services on the basis of demonstrated competence and qualifications at a fair and reasonable price.

The board should rank proposals from auditors according to technical factors. Also, compare the estimated cost to the estimated hours. An unreasonably low estimate of hours or cost may be a reason for rejection.

Steps in Engaging an Auditor

Send an RFP to firms experienced in governmental auditing. If you need assistance finding experienced firms, we can send you a listing of firms who currently complete district audit reports, based on the district's geographic location. Please call us at (512) 239-6170 if we can be of assistance.

When the proposals are received, evaluate and rank them according to

qualifications. Compare estimated costs based upon estimated hours and experience level of the staff. Negotiate costs and other terms with the chosen qualified firm. If terms cannot be agreed to, discuss engagement with another qualified firm. Make sure that the auditor's Engagement Letter confirms the terms agreed upon and provides the necessary information about the scope of the audit.

The Engagement Letter

An Engagement Letter is the auditor's formal communication with his client in which he specifies the terms of the audit. The Engagement Letter clarifies the scope of the audit to avoid misunderstanding and to facilitate billings and collections. The board should carefully review the auditor's Engagement Letter. The letter is the auditor's understanding of what he has been asked to perform.

The Engagement Letter or other written documentation from the auditor should include information on the basis for his fee. The Engagement Letter is **not** a binding contract for the total cost. Ethics rules prevent a CPA from guaranteeing the total cost of the audit by agreement with the client.

To arrange for good ongoing communication, the district's board should designate someone from the district as the auditor's primary contact. If the auditor finds that the actual costs of the audit may exceed the estimate, this situation should be communicated to the designated contact. The board may request and receive a detailed listing of the costs associated with the audit.

Guidelines for an RFP and Engagement Letter

The following paragraphs offer suggestions about points to address when preparing an RFP. Many of the items listed should also be included in the Engagement Letter. This list is not all-inclusive and should be altered to meet each district's needs.

- ❑ **General Information.** Name and address of the entity issuing the RFP. Name, address, title, and phone number of contact person(s). Response deadline and the consequences of late responses. Number of copies of the audit report. The specific contract period year(s) to be audited. Name, title, and signature of the district official responsible for handling the proposal.
- ❑ **Description of Entity and Records to Be Audited.** General information on the district, such as its budget size and component units. Number and type of funds and other pertinent details such as the basis of accounting used during the fiscal year. Magnitude of the financial activity, including the number and location of bank accounts, number of tax receivable accounts, and number of employees. The accounting system, records, and procedures used. List of responsible party who maintains the records and prepared the reports. Availability of copies of prior years' audit reports, management letters, financial statements, and budgets.
- ❑ **Nature of Services Requested.** Specify the scope of the audit—is it a generally accepted auditing standards (GAAS) or generally accepted governmental auditing standards (GAGAS) audit? If the board wants the auditor to review specific areas and provide a special report, this should be specified.

- ❑ **Recommended Qualifications of the Auditor.** An affirmation that the auditor is properly licensed for public practice as a CPA or public accountant in Texas. An affirmation that the auditor has corrected past deficiencies, if any, in his audit work. Copies of all transmittals within the last two years from the TNRCC regarding previous audits. Copies of a peer review or quality review letter.
- ❑ **Exit Conference Requirements.** The RFP and Engagement Letter should specify whether exit conferences or any interim conferences are to be held. If so, the contact person for setting up the meeting should be stated.
- ❑ **Assistance Available to Proposers.** The state and federal agencies and other entities interested in the report, with the name, address and phone number of the contact person. The names and titles of the district's officials or consultants who will issue the Representation Letter (this letter will provide assurance to the auditor that all items have been properly disclosed).
- ❑ **Reports Required.** The RFP and Engagement Letter should specify the number and type of reports that are

required at the conclusion of the audit, including special reports to state and federal agencies or other entities, and who is responsible for the report publication costs. Texas Water Code §49.191(d) requires the audit be completed within 120 days after the close of the district's fiscal year.

- ❑ **Contractual Arrangements.** The Engagement Letter and other written representation should indicate the professional level of staff who will be working on the audit, the estimated number of hours that will be required, and the hourly rate for each staff type.
- ❑ **Retention and Availability of Working Papers.** The working papers should be retained for at least three years by the auditor. The work papers should be available for examination by authorized representatives of the board and state and federal agencies.
- ❑ **Right to Reject Any Proposal.** The board may reject any proposal received, or may negotiate with the potential auditor to adjust the engagement terms. ■

Term of Engagement

The board may wish to consider engaging an independent auditor for more than one annual audit. However, if a district continues to rely on the services of the same auditor for a prolonged period of time, the auditor's independence can be impaired and is usually questioned by the district's customers.

Rule Revisions

Changes in TNRCC rules on river authorities and water districts went into effect in late 1996. These revisions in Chapters 292 and 293 of Title 30, Texas Administrative Code, implement Senate Bill 626 enacted by the 74th Legislature. Downloadable versions of TNRCC rules are available on the agency's Web site (<http://www.tnrcc.state.tx.us/rules>).

Summary of Revisions to Chapter 292—River Authorities

- ♦ Updates use of “commission,” “executive director,” and “chief clerk” to conform to recent Chapter 3 rule revisions.
- ♦ Updates citations to the Water Code, the Public Funds Investment Act, the Public Funds Collateral Act, and the Professional Services Procurement Act.

Summary of Revisions to Chapter 293—Water Districts

- ♦ Updates use of “commission,” “executive director,” and “chief clerk” to conform to recent Chapter 3 rule revisions.
- ♦ Amends notice requirement for creation of groundwater conservation districts.
- ♦ Establishes a procedure for an appeal to the commission of a board member's removal.
- ♦ Eliminates the requirement that districts seek commission approval of bonds reviewed by and sold to the United States Department of Agriculture, Rural Development and the Texas Water Development Board.
- ♦ Amends criteria for the types of costs—organizational, creation, operation, and maintenance—that may be funded with bond proceeds.

Filing Deadlines

A water district must submit a copy of its audit report to TNRCC's executive director for filing within 135 days after the end of the district's fiscal year [Water Code §49.194(a)]. A qualified district can submit an annual financial report within 45 days after its fiscal year ends [Water Code §49.198(c)]. In the accompanying table, several dates have been increased by one or two days because the actual due date fell on a weekend or a holiday.

| <u>IF Your Fiscal Year Ends:</u> | <u>THEN Your Audit Reports Are Due:</u> | <u>OR Your Financial Reports Are Due:</u> |
|--------------------------------------|---|---|
| November 30, 1996 | 4/14/97 | 1/14/97 |
| December 31, 1996 | 5/15/97 | 2/14/97 |
| January 31, 1997 | 6/16/97 | 3/17/97 |
| February 28, 1997 | 7/14/97 | 4/14/97 |
| March 31, 1997 | 8/13/97 | 5/15/97 |
| April 30, 1997 | 9/12/97 | 6/16/97 |
| May 31, 1997 | 10/13/97 | 7/15/97 |
| June 30, 1997 | 11/12/97 | 8/14/97 |
| July 31, 1997 | 12/15/97 | 9/15/97 |

- ♦ Allows for reimbursements to a developer from maintenance tax revenues and establishes application requirements for commission approval on such reimbursements.
- ♦ Establishes the application requirements and criteria for seeking commission approval on revenue notes of a term longer than three years.
- ♦ Clarifies that the commission can recover costs in processing applications to proceed in bankruptcy.
- ♦ Establishes application requirements and filing fees for districts seeking commission approval of a district name change.
- ♦ Provides for executive director approval to initiate district dissolution proceedings under certain circumstances.
- ♦ Expands applicability of standby fees to allow most types of districts that meet the financial qualifications to apply for commission approval of standby fees.
- ♦ Updates citations and references to the Water Code. ■

IV. SUPPLEMENTAL SCHEDULES

Each water district that is proposing to provide or is actually providing as its principal function ***water, sewer, drainage, or flood control/protection facilities or services*** must additionally prepare and present Supplemental Schedules C–N behind the notes to the financial statements. This provision does ***not*** apply to:

- ♦ districts whose ***only*** purpose is to provide irrigation, navigation, or groundwater control;
- ♦ municipal management districts;
- ♦ river authorities or special law districts listed in 30 Texas Administrative Code 292.1.

In addition to these supplemental schedules, the district must submit an Auditor's Management Letter (see V-1).

Auditor's Report and Supplemental Schedules

- C. Auditor's Report on Supplemental Schedules
- D. Notes Required by the Water District Accounting Manual
- E. Services and Rates
- F. Schedule of General Fund Expenditures
- G. Schedule of Temporary Investments
- H. Analysis of Taxes Levied and Receivable
- I. Analysis of Changes in General Fixed Assets
- J. General Long-Term Debt Service Requirements by Years
- K. Analysis of Changes in General Long-Term Debt
- L. Comparative Schedule of Revenues and Expenditures—General Fund and Debt Service Fund—Five Years
- M. Insurance Coverage
- N. Board Members, Key Personnel and Consultants

The above referenced items are requirements of the TNRCC. Any supplemental schedules which are omitted from the district's report for justifiable reasons should be so noted in the audit report table of contents or the table of contents for the Supplemental Schedules, if one is prepared. One reason for an omission would include, for example, the omission of Analysis of Taxes Levied and Receivable (Schedule H) by a district that has never assessed or collected taxes.

Illustrations of Schedules C through N are provided on IV-2 through IV-21.

Enterprise Funds - As stated in the Commission's permanent rules (TAC 30, Rules of the Commission 293), "Districts using proprietary funds (e.g., enterprise funds) in their audited financial statements shall provide sufficient supplemental information to demonstrate compliance with all legal restrictions on the use of district monies. Such supplemental information shall be shown on the format included in the Annual Audit Report Requirements." The use of proprietary funds ***does not*** exempt a district from preparing all supplemental schedules. For example, Schedule F should be used for a district's operating expenses of an enterprise fund if district operations are accounted for in an enterprise fund.

An alternative format for Supplemental Schedule L for districts that use an enterprise fund is provided in **Appendix G**.

The TNRCC maintains an Internet site on the World Wide Web. The site (<http://www.tnrcc.state.tx.us>) includes information about TNRCC's commissioners and their meeting agenda, agency publications, proposed and adopted rules, and pages maintained by the many divisions and sections of the agency to convey specific information about their programs.

There are many sites on the Internet that contain useful information. Examples:

- ♦ other state agencies, such as the Attorney General's Office, Office of the Secretary of State, Texas Department of Commerce, and the Texas Water Development Board;
- ♦ federal government and national organizations, such as the U.S. Environmental Protection Agency, Governmental Accounting Standards Board, and the U.S. Geological Survey;
- ♦ water districts and river authorities; and
- ♦ other sites related to water and wastewater, such as the Edwards Aquifer Research and Data Center and the Texas Water Resources Institute.

Finding Web Sites. As a courtesy to water districts, a TNRCC Web page (http://www.tnrcc.state.tx.us/water/wu/district/faq_link.html) contains links to some of these sources; others can be located by using a search engine available from your Internet provider.

The World Wide Web: Sites of Interest to Water Districts

Please be aware that links from the TNRCC Web server to other sites, which agency staff or customers have found to contain useful information, are provided solely as a courtesy. The TNRCC has no control over the posting of material to other Web sites, and cannot take responsibility for the validity of their content.

Communicating with TNRCC. We invite you to send in any comments or concerns that you may have. Contact the Reports and

Supervision Team of the District Administration Section at our electronic mail address: wu@tnrcc.state.tx.us or call us at (512) 239-6170. If you are not on the Internet, please call the Water Utilities Division's main telephone line at (512) 239-6096, send us a facsimile message at (512) 239-6972, or write to us at Water Utilities Division, MC 152, Texas Natural Resource Conservation Commission, P.O. Box 13087, Austin, Texas 78711-3087.

Response Time. When you inquire by e-mail, the agency's standard practice is to send an automated acknowledgment of receipt. We will provide an initial response within four working days. You should be aware, however, that it might take longer for us to provide you a complete response. The agency's standard approval procedures apply to electronic messages, since the response may contain official guidelines, procedures, or positions.

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